

Transforming the risk management function: Our perspective

The financial services industry is in the midst of a radical transformation. Today's customers demand more options, creative solutions, greater flexibility and faster responses. Survival, much less success, demands an organization with the intelligence, agility and speed to keep pace with today's customers and technologies.

This new market demands a wholly different, transformed risk management function. The risk management function of the future must be capable of supporting new business models in real time, adding value to an enterprise that anticipates and responds to the needs of its customers in a digital world.

Current state

Together with our survey partner, MIT's Golub Center for Finance and Policy, we set out to measure the banking industry's progress on its risk-transformation journey.

The Chinese philosopher Laozi is famous for saying, "a journey of a thousand miles begins with a single step." Based on the findings of our survey, we'd say that the banking industry still faces a long journey indeed. Here's some of what we discovered:



Banks still lack consistent industry definitions or widely accepted metrics to measure risk-management effectiveness.



When it comes to assessing the efficiency of their risk management functions, respondents most often turned to traditional measures such as avoiding regulatory observations and fines.



Banks are planning significant investment—particularly in advanced analytics and risk data management—to support risk management transformation aimed at adding value to business decision-making activities transcending regulatory compliance.

Understanding risk management transformation

Where exactly should the risk-transformation journey lead for the banking industry? We envision a risk management function that creates value by empowering growth and profitability.

The transformed risk management function will exist throughout the enterprise and will focus on managing risk to optimize organizational performance.

The transformed risk management function is digital, leveraging cutting-edge technologies and predictive analytics to anticipate and respond to customer needs with speed, accuracy, and precision.

Instead of only focusing on those risks with direct financial impact (credit, market, liquidity, etc.), the future risk management function must recognize that many other forms of risk can have severe financial impact as well. So in the future, risk management will measure, quantify, and manage such non-financial risks as cyber threats, employee behaviors, reputational risk, and other operations risks resulting from changing business models.

Further, we see the future risk management function being driven by a C-level head of risk or chief risk officer who drives consistency throughout the organization. This executive-level leader should have an influential voice in the structural formulation and execution of business tactics.

Finally, we see an efficient risk function that delivers maximum value for the resources it consumes while driving profitability and shareholder value, and assisting in the management of escalating stakeholder expectations.

Inspiration from digital companies

What does the future of risk management look like in practice? For inspiration, we look beyond banking to leaders in the technology sector.

These cutting-edge companies—including Amazon, Facebook, Google, and Microsoft—are far ahead of banking in the techniques they've adopted to bake risk-awareness into their business models.

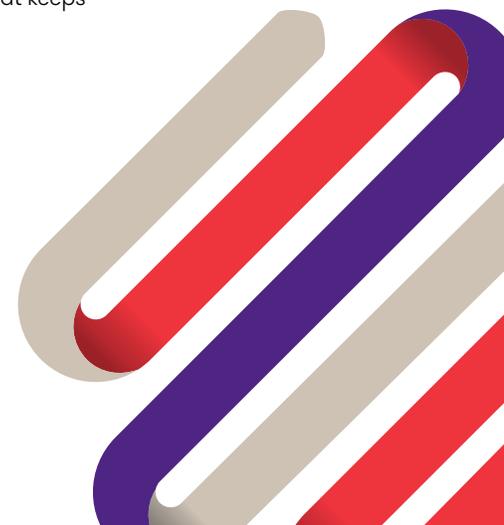
What lessons can banking learn from these tech leaders?

Micro-segmentation is a great example. Tech leaders use advanced data management techniques, analytics and machine learning to go well beyond data mining. They focus on the specific products and services that their customers may need, improving the experience for the customer and increasing profitability.

Another lesson from the digital leaders is their streamlined authentication processes. This must be coupled, of course with strict privacy preservation and appropriate know your customer (KYC) processes.

Risk driven pricing driven by segmentation is another practice from the tech sector that banking could adopt. For banking, that could mean taking the risk profile of the applicant into consideration when determining pricing.

Real-time risk assessment and scoring must become a given. When customers are doing business through their smart phones, as is routine for the tech giants, they expect immediate results. For banking, that means real-time FICO scoring and an infrastructure that operates at a pace that keeps customers engaged.



Uneven adoption

Across the banking sector, we see risk function transformation advancing at an uneven pace, although the business drivers are compelling at all levels.

At the high end of the scale, the Global Systemically Important Banks (G-SIBs) are transforming their risk functions more rapidly than their smaller peers. To a great extent, they have little choice; they deal with multiple regulatory frameworks and obligations across many jurisdictions. At the same time, they need to be profitable in a number of markets while increasing the efficiency of their risk functions.

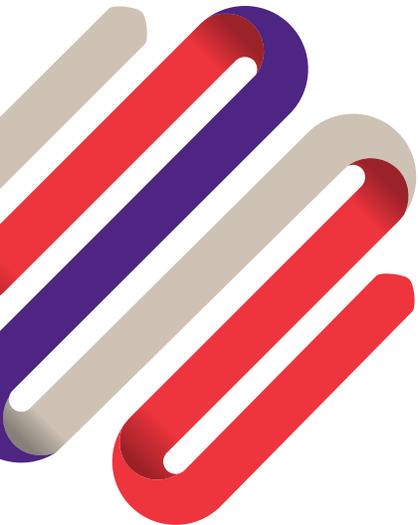
At the other end of the spectrum are a number of smaller institutions, which are typically regional banks; they are quickly facing the need to satisfy increasingly complex regulatory obligations and overwhelming data requirements to implement key new risk activities, such as stress testing and pragmatic operationalization of current expected credit losses (CECL) solutions. Furthermore, incorporating non-financial risks, such as digital and cyber exposures, into the risk function core is becoming critical for truly integrating a cohesive approach to risk management. For them, the transformation of their risk functions will be key to achieving competitive advantage and sustaining profitability. Without transformation, it's hard to see how they can remain independent in a scenario of increasing industry consolidation supported by enabling technology.

Embracing new technologies

Many respondents in our survey expect to adopt new technologies to increase efficiency and performance via more digitalization of the risk function. Chief among these technologies, also contributing to the fintech revolution, are deployment of: artificial intelligence (AI) in cognifying risk identification and assessment activities, advanced data management, superior algorithmic analytics (e.g., deep and learning-machine techniques), robot process and workflow automation, and natural language process, to name just a few. In fact, many large banks are already using robotic process automation (RPA) as they are centralizing testing and streamlining risk assessment activities.

Applying distributed ledger technology (DLT, aka "Blockchain") to risk management activities is at the core of multiple, on-going proof of concepts in the industry. Stating that it could be a foundational technology for the future of risk management still needs additional supporting use cases. However, several related DLT value attributes make it very interesting to explore further, among other: reducing operational risks, optimizing and streamlining risk management and business processes, speeding decision making, and empowering near real-time risk monitoring.

With the incorporation of these technologies, operational risk will be a vital tool of paramount importance in order to fully streamline risk management processes, speed decision making, and empower real-time risk monitoring.



How we can help

Our Advisory Services professionals have significant expertise in risk solutions and industry experience, inclusive of Financial Services, Healthcare, Life Science, and Technology. We help clients define and execute their business strategy in alignment with their overall risk appetite to create business value. We deliver practical, innovative, and holistic risk management programs and solutions to address strategic, operational, financial reporting, regulatory compliance, digital, and cyber risks.

Across many industries, we're helping our clients transform from compliance-based to performance-driven risk management that creates value for their enterprises in seven areas.

1 Risk function transformation

We help clients implement heightened risk management (RM) functions and related processes to increase business value and functional efficiency, improving risk identification, culture, and control effectiveness; and optimizing three-line-of-defense operating models and upstreaming risk activities.

2 Data & risk analytics

We assist clients with implementing model risk management solutions: deploying risk analytics, algorithms, advanced forward-looking methodologies, and data science solutions for regulatory, business, and RM decision-making purposes.

3 Financial risk management

We support clients that are implementing sustainable RM solutions and stress-testing, improving capital, liquidity, market, and credit risks.

4 Operational risk management

We assist clients that are optimizing risk assessment and business processes performance through cohesive operational RM programs, including customer-centric and resilient frameworks covering non-financial risks such as digital, cybersecurity, and third-party/vendor risks.

5 Integrated risk infrastructure and technology

We support clients in the optimal deployment of governance, risk, and compliance solutions, as well as architectures, platforms and tools.

6 Regulatory compliance

We help clients to optimally satisfy changing rules and dynamic regulatory guidelines and to effectively respond to external regulators and supervisors observations and expectations.

7 Controls advisory, forensics and specialized assurance services

We deliver bespoke services for our clients, including leading internal audit sourcing solutions.

Contacts

Jose Molina

Principal
Operations Risk
Grant Thornton LLP
E jose.molina@us.gt.com

Vishal Chawla

National Managing Principal
Risk Advisory Services
Grant Thornton LLP
E vishal.chawla@us.gt.com

Frank Saavedra-Lim

Managing Director
Operations Risk
Grant Thornton LLP
E frank.saavedra-lim@us.gt.com



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